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By Messenger

Mary L. Cottrell, Secretary
Department of Telecommunications and Energy
One South Station, 2nd Floor
Boston, MA 02110

Re: Docket D.T.E. 01-20 – Response to Verizon's Reply Comments Regarding Its Compliance Filing

Dear Ms. Cottrell:

AT&T requests leave to submit this short response to key misrepresentations made in Verizon's reply comments concerning its compliance filing. We do not attempt to respond to all of Verizon's misrepresentations, as many of them have already been fully addressed in the comments that AT&T submitted on March 18. Instead, we focus on the key misrepresentations in Verizon's reply comments that AT&T was unable to anticipate in its initial comments.

I. FLC Factor: As explained below, Verizon's attempt to defend its brand-new FLC factor has no merit, and is based on serious misrepresentations as well as assertions with no basis in any record evidence. Verizon's effort to defend the use of backward-looking demand assumptions in calculating a new estimate of total forward-looking investment makes no sense, and indeed appears to repudiate the use of any FLC factor (of less than one) at all. Verizon's further efforts to show that its purported forward-looking investment is comparable to its total 1999 embedded investment actually show just the opposite, and confirm the accuracy of AT&T's critique.

a. Verizon's Explanation for Using Backward-Looking Demand Assumptions to Calculate a Brand New Forward-Looking to Current Factor Repudiates Use of Any FLC Factor, and Is Completely Inconsistent with Verizon's Own Methodologies.

Verizon tries to defend its use of backward-looking demand assumptions to estimate total forward-looking network investment on three grounds, none of which makes any sense

First, Verizon asserts that total demand has no relevance either to its brand new FLC calculation or to the annual cost factors (ACFs) themselves. *See* Vz's Reply Comments at 8-9. The first part of this claim is demonstrably false. It is undisputed that: (i) Verizon's recurring cost models produce only a per unit cost and not total investment; and (ii) for that reason Verizon attempted in its compliance filing to derive total forward-looking investment by multiplying per unit costs from its model by demand assumptions external to its model. *See* AT&T's Initial Comments at 7. Since Verizon's brand new FLC calculation turns directly on the demand assumptions it made in this calculation, Verizon assertion in its reply comments that demand assumptions are irrelevant is simply untrue. The second part of this claim is even more stunning, because it amounts to a repudiation of Verizon's justification for having any FLC factor (of less than one) at all. If the total demand and therefore the total forward-looking investment that Verizon attempts to calculate has no relevance to the ACFs, then there is no basis for applying any FLC factor to the ACFs. Verizon tries to avoid this pitfall by saying that its ACFs are applied to per unit investment in order to estimate per unit expenses, and thus are only affected by changes in forward-looking unit investment rather than forward-looking total investment. *See* Vz's Reply Comments at 8-9. But this too makes no sense. The 1999 embedded network investments that Verizon used to calculate its ACFs are not per unit figures, they purport to represent total investment.

[1] This is why Verizon's effort to calculate a brand new FLC factor in its compliance filing attempts to estimate total forward-looking network investment, and cannot produce any results merely on the basis of per unit material investment costs. (Similarly, the original 80 percent FLC factor – which Verizon now characterizes as a mere "placeholder" having no evidentiary basis, *see* Vz's Reply Comments at 2 – was not calculated based on any analysis of forward-looking unit investment.)

Second, Verizon argues that not all investment is demand sensitive, asserting for example that new lines does not require new poles. See Vz's Reply Comments at 10. Here Verizon is trying to mislead the Department by discussing how it operates its network, in an attempt to hide how its recurring cost models and new FLC calculation work. Verizon's models do not estimate the total pole investment, or any other total investment. They only estimate per unit costs, and expressly assume that every incremental line will result in the same incremental pole investment. *See* AT&T's Initial Comments at 6. That things work differently in Verizon's network is irrelevant. This is how Verizon's recurring cost models, and its brand-new FLC calculation, work. *Id.* at 6-9.

Third, Verizon argues that its model necessarily includes all forward-looking investment, because FCC regulations require TELRIC models to estimate the total forward-looking cost for each element. *See* Vz's Reply Comments at 10, citing 47 C.F.R. § 51.511 (a). This abstract point about how TELRIC models are supposed to work has no relevance here. It is nice that Verizon finally, though rather belatedly, admits that the FCC's TELRIC rules require that UNE rates be set by estimating the total forward-looking cost of each network element, and then dividing by total retail and wholesale demand to derive a per unit cost. *Id.* But it is undisputed that Verizon's models do not work that way. *See* AT&T's Initial Comments at 6. Verizon's models only calculate a per unit cost, and that is why Verizon had to resort to applying external demand assumptions when it tried to calculate forward-looking network investment in order to derive an entirely new FLC factor in its compliance filing. *Id.* at 6-9.

In sum, Verizon's reply comments regarding the unproven and entirely backward-looking demand assumptions that it applied in calculating a brand new FLC factor seem to have been drafted without any regard for what is contained in Verizon's cost models or compliance filing. The new FLC factor in Verizon's compliance filing was derived using indefensible, backward-looking demand assumptions. Instead of offering any defense for them based on any record evidence, however, Verizon instead tries to pretend that demand assumptions are irrelevant to its new FLC factor. Pretending cannot make it so.

b. Verizon's False Statements, Conclusory Assertions Based on No Record Evidence, and Admissions Confirm that Its Post Hoc and Ad Hoc Guesstimate of Forward-Looking Investment Is Fatally Flawed.

1. *Missing RTU Fees*: Verizon asserts that no Right-to-Use ("RTU") fees were included in its 1999 embedded network investment because those fees were all recorded to its intangible assets account, and not to its digital switching account. *See* Vz's Reply Comments at 12-13. That assertion is false, as shown by record evidence in this proceeding. Verizon's witnesses testified that

[1] Ex. VZ-37, Verizon's Recurring Cost Study, Part G-5, Tab 2.

only after 1999 did it begin recording RTU fees as intangible assets; prior to that time it capitalized them in its digital switching account.[2] Since the evidence shows that RTU fees are included in the 1999 embedded investment, Verizon erred by calculating a new FLC factor which excludes RTU fees from the estimate of forward-looking investment.

2. ***Missing DSL Investment***: Verizon concedes that it erred by failing to include DSL-related investment in its purported accounting of total forward-looking investment. *See* Vz's Reply Comments at 14. Verizon tries to downplay this error, by asserting (with no support from any record evidence) that in 1999 it had only $41 million in DSL investment in Massachusetts. But Verizon's 1999 DSL investment was only the tip of the forward-looking iceberg. On or about March 20, 2003, Verizon announced that it was substantially increasing its DSL investment in Massachusetts in order to make DSL services available to 80 percent of its customers, rather than the current 60 percent.[3] Since Verizon was just starting to offer DSL in 1999, has substantially increased its DSL investment since then, and recently announced a substantial further investment in the near future, it is evident that Verizon's brand new FLC calculation improperly ignores hundreds of millions of dollars of DSL-related investment that would be in the forward-looking network. Fixing this one error alone would increase Verizon's newly calculated FLC factor by many percentage points.

3. ***Other Missing Investment***: Verizon also concedes that it erred by failing to include the investment associated with "Virtual Private Networks and the other services that AT&T identifies," including frame relay, cell relay, and other data ATM services, a variety of specialized video conference and other video services, and the many other specialized services offered by Verizon. *See* Vz's Reply Comments at 14; AT&T's Initial Comments at 14. With no citation to any record evidence or any other support whatsoever, Verizon conjectures that this missing forward-looking investment amounts only to "a few million dollars." *Id.* Since no record evidence supports this incredible claim, the Department may not credit it. As for E911 equipment, Verizon asserts that the cost of such equipment was not included in its 1999 embedded investment figures. But Verizon again cites no evidence for this assertion, which is inconsistent with the representations its witness made at the recent technical sessions – without caveat – that the 1999 embedded investment figures used in Verizon's brand new FLC calculation included all investment for "the entire network." *See* AT&T's Comments at 12.

4. ***Incomparability Due to Massive CPR Errors***: Verizon argues that it would be improper for the Department to pay any attention to the almost $1 billion in missing embedded investment that Verizon should have included, for the sake of comparability, in its *post hoc* calculations of total forward-looking network investment. *See* Vz's Reply Comments at 15. Verizon argues that because "the FCC has never ordered Verizon to remove these assets from its books" the Department may not consider how Verizon's new FLC calculation has been distorted by them. *Id.* This assertion is baseless. In November 2000 the FCC opted not to pursue further investigation of the serious errors in the continuing property records ("CPRs") for Verizon and other RBOCs, but only because those substantial misstatements no longer had material implications for rates set by the FCC given the FCC's mandated reductions in interstate access charges.[4] However, the FCC stressed that its

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[2] Tr. 1650, 1/24/02.

[3] *See* http://digitalmass.boston.com/news/2003/03/20/verizon.html (March 20, 2003, article from the BOSTON GLOBE, written by Peter J. Howe).

[4] *In the Matter of 1998 Biennial Regulatory Review – Review of the Depreciation Requirements for Incumbent Local Exchange Carriers*, CC Docket No. 98-137, "Second Report and Order," No. FCC 00-396,
(continued...)

"auditors found, and the RBOCs did not seriously challenge, that the CPRs were not well maintained," and emphasized that its "decision in this order does not preclude the states from investigating relevant state issues raised by the CPR audits."[5] Verizon's attempt to get away with calculating a brand new FLC in a manner substantially distorted by the massive flaws in its 1999 CPRs has no good faith basis.[6]

(...continued)
¶ 11 (rel. Nov. 7, 2000). *See* http://ftp.fcc.gov/Bureaus/Common_Carrier/Orders/2000/fcc00396.doc.

5 *Id.* ¶¶ 12-13.

6 Verizon also asserts it demonstrated to the FCC in September 1999 that it found "almost all" the missing equipment. But, as AT&T pointed out in its initial comments, upon review the FCC's Accounting Standards Division rejected this claim. *See* FCC Press Release titled "Corrections to Audit Reports of Bell Operating Companies' Continuing Property Records, CC Docket No. 99-117, ASD File No. 99-22," released 10/22/99.

c. Adopting a FLC Factor of 80-90 Percent Would Represent a Substantial Reduction From the "True" Starting FLC.

Verizon asserts that the Department should have expected the FLC factor to be "considerably" below 80 percent. *See* Vz's Reply Comments at 2. The sole basis for this assertion is that the Department's order summarizes Verizon's claims that an 80 percent FLC would be "conservative" and that "Verizon MA's own TELRIC proposals … would produce a FLC of 65 percent." *Id.* However, the 80 percent figure was never a real starting point. It was never proven by Verizon and was never based on any record evidence. Rather, it was pulled from thin air by Verizon, which now characterizes the number as a mere "placeholder." *Id.* at 2. Furthermore, Verizon always acknowledged that its calculation of a 65 percent figure in its surrebuttal testimony could not be relied upon to set a FLC factor, conceding that the forward-looking investments it assumed were incomplete at the very least because they excluded the *substantial* investments that Verizon's models categorize as "support."[7] The calculation that produced the 65 percent figure was fatally flawed both because it ignored the $1.7 billion in support-related investments subsequently identified by Verizon, and because it suffers from the same substantial errors that AT&T identified (and that Verizon in large part admits exist) in Verizon's compliance filing. From the available information it appears that the starting point should have been at or very close to 100 percent, and not the 80 percent arbitrarily selected by Verizon. Thus, adopting a FLC factor of between 80 and 90 percent at this time would in fact reflect a substantial reduction from the "true" FLC factor implicit in Verizon's original models.

II. <u>Avoidable Retail-Related Expenses</u>: Verizon admits that rather than modify the avoidable expense calculations in its current model as proposed by AT&T and directed by the Department, it threw them out and substituted a very different calculation from its 1996-era model. *See* Vz's Reply Comments at 17-18. The Verizon recurring cost models adopted by the Department in this proceeding differ from the models adopted in 1996 in the *Consolidated Arbitrations* proceeding. They differ not just in the inputs assumed by Verizon, but also differ markedly in structure. In this proceeding Verizon recognized that, for the sake of internal consistency, in its new models avoidable retail expenses must be calculated by analyzing categories of expense excluding depreciation expenses.[8] It was improper for Verizon to recalculate avoidable retail expenses *including* depreciation expenses, solely to *decrease* the percentage of expenses estimated to be avoidable retail expenses. *See* AT&T's Initial Comments at 19-22.

III. <u>Labor Rates for NRCs</u>: Verizon admits that in its compliance filing it assumed that in 2003 and 2004 its labor rates will increase will continue to increase by four percent per year, despite the fact that the Department made no such finding (and was not asked to do so by Verizon). *See* Vz's Reply Comments at 19. That was improper. There is no record evidence to support this assumption, and it is highly unlikely that Verizon's labor rates in 2003 and 2004 will increase at the same pace they did during 1999. If this issue were in fact being litigated, it would be quite reasonable for the Department to project that in 2003 and 2004 Verizon's average labor rates are unlikely to increase at all. But since there is no record evidence to support any finding regarding labor rates in 2003 or 2004, and since the Department made no such finding, it was improper for Verizon to inflate its non-recurring cost labor rate assumptions in its compliance filing without authorization.

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7 Ex. VZ-38a at 7-8.

8 *See* Tech. Session Tr. 53-54, 3/5/03; Ex. VZ-37, Verizon's Recurring Cost Study, Part G-1, Tab 1.

IV. <u>Conclusion</u>: AT&T respectfully urges the Department to reject Verizon's reply comments, and to direct Verizon to make the corrections or changes that AT&T demonstrated above and in its Initial Comments are necessary. Verizon should be able to make these corrections and resubmit (and distribute to all parties) electronic versions of its corrected cost studies, rate summaries, and tariffs in a matter of a few days. It is vitally important that Verizon not be permitted to delay the adoption of final UNE rates.

Very truly yours,

Kenneth W. Salinger

pc: Marcella Hickey, Esq., Hearing Officer
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Service List